FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

January 8, 2010

Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Re: Request for Comment on the Proposed Amendments to the Mortgage Provisions of Regulation Z (Both Closed-End Credit Rules and HELOC) (Docket Nos. R-1366 and R-1367)

Dear Mr. Chairman:

On behalf of the Federal Deposit Insurance Corporation, we commend the Board of Governors of the Federal Reserve System (FRB) for proposing amendments to Regulation Z to provide new substantive protections and to significantly revise the rules for disclosures for closed-end credit secured by real property or a consumer's dwelling, and open-end credit secured by a consumer's dwelling. The proposed amendments respond to an urgent need for both simplification and improvement of disclosures provided to consumers during the mortgage application and closing process. Moreover, new substantive consumer protections that would be established, particularly the proposed ban on "yield spread premiums," would help to prevent predatory practices not remedied through enhanced disclosures alone.

One of the root causes of the mortgage crisis was that many consumers were not provided the information they needed to understand the complex mortgage products that pervaded the market. Many nontraditional products, such as payment option adjustable rate mortgages and interest only mortgages, were marketed to consumers based solely on their ability to pay the initial monthly payment without consideration of the consumer's inability to pay a fully amortizing payment. Marketing focused on these low "teaser" payments masked the equity-stripping or absence of equity building that could result from negative amortization or interest only payments. Recent events have clearly demonstrated that increasingly complex financial products combined with opaque marketing and disclosure practices result in substantial risks, not just for consumers, in terms of sometimes devastating financial consequences, but also for institutions and investors. The FDIC's experience with failed bank portfolios confirms that structurally unsound mortgages burdened by substantial negative equity are very difficult to restructure into sustainable mortgages. As a result, these mortgages place many consumers at grave risk of foreclosure.

The FRB's proposed changes to the Truth-in-Lending Act (TILA) disclosure requirements would more effectively inform consumers about the specific risks presented by various types of mortgage loans and continue efforts to control abusive practices. Streamlining and revising TILA disclosures to provide greater transparency regarding the true costs and risks of financial products will ensure that borrowers have the tools necessary to effectively compare mortgage loan terms when shopping for, and ultimately selecting, a mortgage product.

While it is critical to fully inform consumers about financial products, including mortgages, consumer testing has shown that, to effectively protect consumers from harm, mere disclosures are not enough.[1] In addition, as we have seen over the last several years in the mortgage crisis, by their nature, some features of financial products create incentives for harmful practices that increase the costs of credit and are not transparent to consumers. To properly protect consumers, certain features or activities require regulatory limitations, particularly for non-traditional and high-cost loans, where our recent experience indicates consumers are particularly vulnerable to abusive practices. For example, yield spread premiums (YSPs) provide an incentive for originators to charge borrowers as much as possible to reap the benefits of the interest rate spread. Existing disclosures do not clearly inform consumers about the relationship between increased costs and YSPs; essentially, the price impact is hidden from the consumer. Consequently, the FDIC strongly supports the FRB's proposal to prohibit payments to loan originators that are based on the loan's terms and conditions when paid to mortgage brokers by lenders. A ban on YSPs will help reduce the likelihood that broker compensation results in a loan that is more expensive than one for which the borrower would otherwise qualify.

While the proposal would advance consumer interests considerably, we urge the FRB to make further enhancements to Regulation Z. For example, while we are pleased that the FRB recently adopted an "ability to repay" standard in connection with higher-priced mortgage loans and high cost mortgages, we believe that an ability to repay standard should be required for all mortgages, including interest only and negative amortization mortgages and Home Equity Lines of Credit (HELOCs). As noted above, interest only and negative amortization mortgages must be underwritten to qualify the borrower to pay a fully amortizing payment. Otherwise, the consequences we have seen during this crisis will recur. Similarly, the practice of making a HELOC without taking into account the consumer's ability to repay, based on the fully drawn line, or without taking into account the consumer's other obligations, should be prohibited. When unaffordable mortgage loans are made, the individual borrower and broader communities are subjected to unnecessary risks. FDIC insured banks are already subject to this type of prudential standard. To promote a more even playing field and prevent circumvention of this requirement by nonbank lenders, we believe such an ability to repay standard should apply across-the-board. Ability to repay is vital to a prudent underwriting determination to both protect creditors from monetary losses, and consumers from loss of their homes.

Enclosed are detailed comments from FDIC staff on the FRB's proposals and views about how the provisions could be strengthened further to protect consumers and ensure they have the information they need to make informed decisions about mortgage products. We

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[1] 74 Fed. Reg. 43232, 43281 (Aug. 26, 2009).

appreciate the opportunity to comment and encourage the FRB to consider the FDIC's recommendations.

Sincerely,

Sheila C. Bair

Enclosure

C c: Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

FDIC STAFF COMMENTS TO REGULATION Z MORTGAGE PROPOSALS (Docket Nos. R-1366 and R-1367)

I. Closed-End Credit Secured by Real Property or a Consumer's Dwelling

1. Prohibited Payments to Loan Originators

The FDIC strongly supports the FRB's proposal to ban yield spread premiums (YSPs). This practice creates a direct incentive for brokers to "price up" loans. We also support the requirement that, when the consumer pays a mortgage broker's fee, no other party may do so.

The FDIC has been a vocal advocate for a ban on YSPs. Other compensation options for loan originators, including flat fees or fees based on the total principal amount of the mortgage, will assist borrowers in avoiding the inherent conflict of interest created for loan originators when they are paid more at the ultimate expense of the borrower. Compensation options other than YSPs will also be more transparent and understandable to borrowers than the traditional premium embedded in the interest rate offered a consumer. Borrowers should continue to have the option to finance the loan originator's fees.

Broker Disclosures and Agreements

As noted in the proposal,[2] the FRB has considered adopting broker disclosure requirements, but so far has been unable to develop and test one that is simple and clear. At this time, neither RESPA nor TILA effectively informs the consumer about broker charges. Many states require mortgage-broker fee agreements, or similar disclosures. However, a uniform, federally-mandated broker disclosure that provides a minimum standard for disclosure of both the broker's role in the transaction, and its fees, is necessary for adequate consumer understanding of the broker relationship. We believe that nothing will reform originator compensation practices better than shining the light of day on them. We strongly recommend that the FRB develop a minimum standard broker disclosure and require that it be used by lenders.

2. Optional Proposal on Steering by Loan Originators

The FRB seeks comment on whether loan originators should be prohibited from directing or "steering" consumers to a particular creditor's loan products if the loan originator would receive additional compensation, but where the loan may not be in the consumer's interest. The FRB asks whether this proposed rule would be effective in achieving its stated purpose. The FRB also asks about the feasibility and practicality of such a rule, as well as any unintended adverse effects the rule might have. Although the FDIC supports the concept of a ban on steering, we do not support the proposed safe harbor.

We share the concerns expressed by the FRB that its proposal to prohibit certain payments to loan originators will not, by itself, protect consumers from the risk that a loan originator may steer consumers to the creditor that offers greater compensation to the originator. The creditor may, in effect, ignore possible transactions having lower interest rates (or other desirable

[2] *Id.*

features) that are available from other creditors because those creditors offer lower compensation. The FRB proposes that in connection with the anti-steering prohibition, a safe harbor would be created where there would be no violation if the loan originator were to present at least three loan options for each type of transaction (fixed-rate or adjustable-rate loan) in which the consumer expressed an interest. Under the proposal, the options would be required to meet several conditions, including, among others, that the loan originator obtain loan options from a significant number of creditors with which the originator regularly does business. To qualify for the safe harbor, the three loan options presented must include: (1) the loan with the lowest interest rate, (2) the loan with the second lowest interest rate, and (3) the loan with the lowest total dollar amount for origination points or fees and discount points.

The FDIC opposes the creation of this safe harbor as it may enable loan originators to demonstrate pro forma compliance with the rule in situations where they were actually engaging in "steering," in order to increase their own compensation. For example, a loan originator could decide that it will no longer do business with those creditors who do not offer the highest compensation. In this situation, a loan originator would remain eligible for the safe harbor even if it offered the requisite three loans from a pool of high-cost lenders offering higher compensation, when the borrower would be eligible for a lower cost product. Essentially, the safe harbor could too easily be "gamed." Although loan originators may argue that competition will control for such a result, the recent mortgage crisis clearly demonstrates that competitive forces alone do not always correct egregious predatory lending practices.

Furthermore, this safe harbor might have the unintended effect of limiting supervisory action and enforcement for deceptive, unfair or misleading behavior and hindering consumers harmed by a loan originator's pro forma compliance from seeking any remedy. If a creditor were to comply with the technical requirements of the proposed safe harbor, a regulator or consumer wishing to challenge the creditor would face a heightened evidentiary burden to prove that a Regulation Z violation had occurred, as the creditor would likely assert good faith reliance to defend against the challenge. Examiners should be fully empowered to evaluate whether the institution is complying with the rule's intent. Institutions should be encouraged to include disclosures on product alternatives as an element of a compliance management program that includes policies, procedures and self-testing.

Accordingly, the FDIC strongly recommends that the FRB adopt the anti-steering prohibition without a safe harbor that would shield bad actors from both administrative enforcement and civil liability. A rebuttable presumption of compliance rather than a safe harbor may be appropriate, so that regulators and consumers alike would retain an avenue for remedying situations where the creditor may have complied with the letter, but not the spirit of the law.

3. Disclosures

As the FRB's consumer testing reveals, many consumers find the numerous disclosures required in connection with the mortgage lending process to be too complicated, conflicting and duplicative. It is critical to the long-term health of our economy as a whole that consumers be better informed when making financial decisions of great consequence, such as choosing a mortgage product.

A key matter of general concern is that disclosures required under TILA developed by the FRB and disclosures required pursuant to the Real Estate Settlement Procedures Act (RESPA) developed by the Department of Housing and Urban Development (HUD) were created through separate processes. This has resulted in a package of mortgage disclosures that lack the type of consistency, clarity and coordination that would best serve consumers. The FRB acknowledges the need to work with HUD to ensure that disclosures under TILA and RESPA are compatible and complementary. We urge immediate collaboration between the FRB and HUD in this regard.

a. "All-in" Annual Percentage Rate

The FDIC commends the FRB for seeking to improve the mortgage disclosure landscape. In particular, we support the proposed "all-in" annual percentage rate (APR), which should enable consumers to more effectively compare mortgage products. We agree with the FRB that the patchwork "some fees in, some fees out" approach that currently applies to the calculation of the APR undermines the effectiveness of the APR as an accurate measure of the cost of credit expressed as a yearly rate.

b. Delivery of Complete and Accurate Early and Final Disclosures

In conformity with the requirements of the Mortgage Disclosure Improvement Act of 2008, the FRB has proposed two alternatives regarding when re-disclosure of the "final" TILA disclosures would result in a 3-day waiting period before consummation may occur. Under the proposal, final TILA disclosures must be received by the consumer at least three business days before consummation, consistent with one of the two alternatives described below.

- Alternative #1: If any terms change after the "final" TILA disclosures are provided, then another final disclosure would need to be received by the consumer at least three business days before consummation.
- Alternative #2: If the APR exceeds a certain tolerance or an adjustable rate-feature is added after the "final" disclosures are provided, then another final disclosure would need to be received at least three business days before consummation. Under the second alternative, all other changes may be disclosed at consummation.

Under either alternative, consumers may be subjected to significant harm where a loan closing is delayed, including moving delays, in the case of home purchases, or delays in their ability to make payments for other contractual obligations, make alternative investments or address family needs in the case of refinances. Moreover, consumers may have very few options available to them to obtain replacement financing from another creditor, if the credit terms they expect to apply to a transaction are changed to less advantageous ones close to the time of loan settlement.

Creditors should be held accountable for accurate disclosures. Requiring creditors to absorb increased costs after the "final disclosure" would motivate creditors to take greater care in disclosing accurate estimated costs earlier in the application process. Moreover, the creditor should not be permitted to delay closing by presenting a consumer with other significant term changes, such as the addition of an adjustable-rate feature, prepayment penalty, or any of the other risky features identified as such in the TILA disclosures, after the "final" disclosure is provided, absent a changed circumstance. Permitting a creditor to make such changes at the eleventh hour effectively endorses a bait-and-switch at the expense of the borrower. Delaying closing three days in the event of a change in terms simply does not afford consumers a meaningful remedy. For example, at this stage in the process, obtaining alternative financing in order to avoid the creditor's unilateral change to the terms of the transaction would be extremely difficult.

The FDIC therefore recommends that the FRB consider "fixing" the terms disclosed in the "final" disclosure, except in the event of "changed circumstances," such as those permitted by the new RESPA rules (effective January 1, 2010).[3] Creditors should not be permitted to simply re-disclose the "final" TILA disclosures, resulting in a closing delay that may significantly harm the borrower or seller. A definition of "changed circumstances" similar to that employed in connection with RESPA could be adopted.

Additional technical disclosure enhancements are outlined in Appendix A to this letter, for your consideration.

4. Credit Insurance Protections

The FDIC supports the FRB's proposed protections in connection with credit insurance products. Specifically, we agree that consumers may not understand the voluntary nature, costs, and eligibility restrictions of credit insurance. We also agree that many consumers may not realize that there may be significantly less costly alternatives to these products. As such, we support the FRB's proposal to require creditors to determine that consumers satisfy certain eligibility requirements at the time of enrollment in a credit insurance product. This requirement would help prevent borrowers from unwittingly purchasing products that are ultimately of no benefit because eligibility criteria were not met.

The FRB solicits comment on whether creditors should also be required to determine whether the consumer meets a product's age or employment eligibility criteria after the product is sold (e.g., before renewing an annual premium), or whether creditors should be required to provide notice when the consumer exceeds the age limit of the product after enrollment. The FDIC recommends that the FRB require creditors to determine whether the consumer meets any age-related eligibility criteria when a product is renewed, as the borrower's date of birth is in the creditor's possession. With respect to employment or other eligibility criteria, the creditor should be required to send a notice, at the time of product renewal, reminding the consumer of the applicable criteria, and disclosing details about the consumer's ability to cancel the product.

Finally, we are aware of consumer complaints about abuses in credit insurance sales related to mortgage products, particularly transactions involving less financially sophisticated borrowers; as the FRB stated in its proposal, the "merits of this product have long been

[3] See, generally, 24 C.F.R. 3500.7(f).

debated."[4] To protect those consumers who may be at greatest risk of high-pressure sales tactics, we recommend that the FRB prohibit creditors from offering credit insurance or similar products at or before the time of consummation of a higher-priced mortgage loan. Such a prohibition would not restrain a creditor from offering these products after consummation. However, the prohibition would prevent the more egregious sales tactics that may lead a consumer to believe that the product is required in order to qualify for the loan, despite the proposed disclosures to the contrary.

II. Open-End Credit Secured by a Consumer's Dwelling/Home Equity Lines of Credit (HELOCs)

1. Credit Line Suspension and Reduction

TILA and Regulation Z permit a creditor to temporarily suspend advances or reduce a credit line under a HELOC for several reasons. The FDIC is keenly aware of the significant increase in HELOC suspension and reduction actions in connection with the mortgage crisis over the last several years. Recent downward trends in home values have led many institutions to take such actions to protect themselves from additional credit exposures. Such actions may be both prudent and appropriate credit risk management practices. However, institutions initiating suspensions and reductions must do so in compliance with both Regulation Z and other consumer protection requirements. Recognizing this balance, in 2008 the FDIC reminded FDIC-supervised financial institutions of their compliance obligations, and urged institutions to work with borrowers to minimize hardships that may result from suspensions and reductions.[5]

HELOCs provide a benefit to consumers in the form of future access to funds that is not available in typical closed-end mortgage products. The open-ended nature of the credit, however, also serves to expose creditors to certain risks not applicable to closed-end mortgage products. The FRB has thus proposed additional guidance in connection with two of the permitted bases for HELOC suspensions or reductions: (1) "significant" decline in property value; and (2) material change in consumer financial circumstance, both of which are discussed below.

a. Significant Decline in Property Value

The FRB proposes to revise staff commentary to Regulation Z to address both creditor uncertainty about what constitutes a "significant" decline in the context of loans with a high combined loan-to-value ratio (CLTV), and the appropriate consumer protections to prevent arbitrary credit line suspension or reduction by creditors. The FRB notes that creditors have expressed concern over how to determine when a decline is "significant," specifically in the context of HELOCs with a high CLTV as of origination. An existing safe harbor provides that a

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[4] 74 Fed. Reg. 43313 (referencing, as an example), Credit CARD Act of 2009, Public Law No. 111-24, § 509; 123 Stat. 1734, 1763 (2009)(requiring the General Accounting Office to provide a report to Congress by December 31, 2010, of the suitability of credit insurance, debt cancellation agreements, and debt suspension agreements for target customers, the "predatory nature" of such offers, and the loss rates compared to more traditional insurance products).

[5] FDIC Financial Institution Letter on "Home Equity Lines of Credit" (FIL-58-2008)(June 26, 2008).

decline is "significant" if, as a result of the decline in the value of the property securing the plan, the creditor's equity cushion is reduced by 50 percent.

The proposal would provide an additional safe harbor for plans with a CLTV at origination of 90 percent or higher. Specifically, for plans with a CLTV of 90 percent or higher, the FRB proposes that a decline in value would be "significant" if there is a 5 percent reduction in the property value on which the amount of the original line was based. The FDIC appreciates the need for additional guidance as to what constitutes a "significant" decline permitting line suspensions or reductions. However, we have reservations that any safe harbor that specifically applies to high CLTV lines may appear to promote excessive risk associated with such lines.

Thus, with respect to reductions in line amounts based on a decline in property value, we propose that any reduction in line amount be prohibited, beyond that which is necessary to restore the creditor's equity cushion at origination, measured as a percentage of the home value not encumbered by debt. For example, assuming a property valued at $100,000 at origination, with an $80,000 first lien, a $10,000 HELOC, and a $10,000 equity cushion (a 10% cushion), if there were a 5% decline in property value, the creditor should not be permitted to reduce the HELOC below $5,500 - the point at which the equity cushion would once again be 10%. To permit the creditor to reduce the HELOC further would be to alter the deal that was originally reached, depriving the consumer of the benefit of his or her bargain.

At the time a HELOC was originated, the underwriting institution offered specific loan terms for the transaction based on the borrower's financial condition. The institution assumed a certain amount of credit risk in this process, which is reflected in the interest rate and fees charged to the consumer. Limiting an institution's ability to reduce the credit available in a HELOC to an amount that maintains the institution's original equity position is consistent with the risk the consumer paid the institution to accept and the underwriting guidelines that were used to originate the loan.

As discussed below, the FDIC is also concerned that consumers are not adequately informed about the risk that a credit line may be suspended or reduced. The proposed early HELOC disclosure would require the following warning: "You may not be able to borrow from your line of credit." In conjunction with this statement, the proposal requires creditors to insert a brief statement about the circumstances that may trigger line suspension or reduction. Creditors have traditionally included a statement, when applicable, that indicates that a "HELOC may be suspended or reduced if the value of the property declines significantly." This generic statement fails to sufficiently inform consumers about the risk of loss of the line of credit, because the average consumer, without additional information, is unlikely to understand that a 5 percent decline (or less, assuming the creditor does not wish to take advantage of a safe harbor) might be considered "significant." Accordingly, we propose the addition of a model statement in the disclosures explaining that a decline in property value may be considered "significant" when the decline is as small as 5 percent or less.

b. Material Change in Consumer Financial Circumstances

A creditor may suspend or reduce a HELOC when there is a material change in the consumer's financial circumstances. The FRB's proposal would clarify that evidence of a material change may include credit report information showing late payments and other derogatory information in the consumer's credit report. The FRB solicits comment on whether and under what circumstances credit score declines alone would constitute a "material change" in financial circumstances. The FDIC submits that a credit score decline, on its own, should never serve as a justification for suspensions or reductions.

Credit scores can decline dramatically not only when borrowers fail to repay their debts in a timely manner, but also when consumers take actions to manage their personal finances in a responsible manner. For example, closing several credit card accounts, especially those that have been paid as agreed for a long period of time, can have a negative affect on a consumer's credit score. Because a decline in a credit score does not always reflect a reduction in a borrower's ability to repay, it should not be the sole basis for reducing or suspending a HELOC.

A credit score may serve as a "screening tool" for creditors to monitor changes in a consumer's circumstances. However, creditors should be prohibited from taking action based solely on a credit score decline, but rather should rely on an independent factor underlying such a decline (e.g., bankruptcy) demonstrating a "material change." Further, once an independent factor justifying HELOC suspension or reduction is determined to exist, action taken by the creditor should be proportionate to any increased risk of default.

The FRB also seeks comment on whether late payments of 30 days or fewer (on obligations other than the HELOC) would be adequate evidence of a failure to pay a debt, for purposes of suspending or reducing a line. Late payments on other debts do not necessarily indicate that borrowers are unwilling or unable to make their payments on a HELOC. Accordingly, the FDIC recommends that late payments on other obligations not serve as the basis for suspension or reduction of the HELOC, with the caveat that a provision in this regard should only apply to HELOC originations after the effective date of the change in the regulation.

The FDIC believes that lenders should consider suspending or reducing HELOCs based on how well the borrower performed on the HELOC, not on unrelated debts owed to third parties. This type of approach is consistent with the performance based approach the federal financial institution regulatory agencies use to assess credit quality.

c. Notice of Suspension/Reduction

The FRB's proposal does not address the timing of notices to consumers of credit line suspension or reduction. Creditors are currently required to provide notices of credit line suspensions or reductions within three business days after the action is taken.[6] We recommend that the FRB consider a change in the current timing requirement in order to expedite a consumer's receipt of such notices. We propose that the FRB revise section 226.9(c)(1)(iii), to require that notice of suspension or reduction be delivered to affected borrowers within 24 hours

[6] 12 C.F.R. § 226.9(c)(1)(iii).

of the creditor's suspension or reduction of the line of credit by either overnight mail sent within 24 hours or a telephone call, followed by written notice. The benefits to a borrower of expedited notice significantly outweigh the costs to the creditor. For example, earlier notice would allow consumers to manage their finances with the knowledge that HELOC funds will be unavailable and to protect themselves from potential insufficient funds or late fees on other obligations that the borrower may incur when writing checks from the affected line of credit before learning of the suspension or reduction.

d. Reinstatement of Accounts

The FDIC commends the FRB's effort to enhance consumer protection relating to the reinstatement of credit privileges. We agree that creditors should provide additional information in notices of suspension or reduction about a consumer's ongoing right to request reinstatement, and the creditor's obligation to investigate this request. In addition, we support the proposal to require creditors to complete an investigation of a request for reinstatement within 30 days of receiving a request and to provide notice of the results when credit privileges are not restored.

In addition, the FDIC strongly supports the FRB's proposal to require that creditors cover first time reinstatement investigation costs. To permit the assessment of fees on consumers would deter consumers from requesting an investigation. The creditor is in a better position than the consumer to absorb the costs of such investigations. Moreover, if the creditor knows that it will bear reinstatement investigation costs, such knowledge is likely to prevent the creditor from suspending or reducing credit lines without first performing the appropriate due diligence to ensure that such action is justified. Such a requirement will also help protect the institution from the legal and reputation risks that may arise when suspending or reducing a HELOC, as the creditor is seeking to change the credit terms currently applicable, potentially based on limited information rather than an in-depth review of a particular situation.

e. Limitation on Early Termination Fees

The FDIC is concerned about the serious impact HELOC suspensions and reductions may have on affected consumers. To the extent that a consumer wishes to replace a suspended or reduced HELOC, the consumer should not be penalized for such action with termination fees or the recapture of closing costs. These types of penalties may seriously hinder the borrower's ability to economically obtain replacement credit. As such, we encourage the FRB to consider "prepayment penalty restrictions" for HELOCs. We would suggest that creditors not be permitted to originate a HELOC that includes a provision for a termination fee or for the recapture of closing costs that would apply during the duration of any HELOC suspension or reduction.

2. Account Terminations

As noted by the FRB, Regulation Z currently permits a creditor to terminate a HELOC account for several reasons, including when the borrower has "fail[ed] to meet the repayment terms of the agreement for any outstanding balance." The FRB solicits comment on whether a delinquency threshold of more than 30 days is appropriate or whether some other time period would better achieve the purposes of TILA. The FDIC suggests that the FRB allow a delinquency threshold of no less than 90 days to trigger account termination. Termination typically triggers the creditor's ability to accelerate the borrower's payment of the entire outstanding balance, exposing the borrower to significant risk. A 90 day or greater threshold, as compared to a 30 day or greater threshold, poses little incremental risk to the creditor (who may protect itself, in the interim, by suspending the line), while significantly enhancing protections for borrowers.

A 90 day or greater delinquency threshold would be consistent with the *Instructions for the Reports of Condition and Income*, which permit an institution to continue accruing interest income on a HELOC until the loan is 90 days past due unless the institution determines that full collection of principal and interest is not expected before that point in time. In addition, the interagency *Uniform Retail Credit Classification and Account Management Policy* establishes standards for the classification and treatment of retail credit, including loans to individuals secured by their personal residence. This guidance specifies that institutions should recognize losses on residential real estate loans no later than 180 days past due. Thus, specifying that a HELOC must be at least 90 days delinquent prior to termination would not be inconsistent with the timeframes specified in existing regulatory guidance.

3. Disclosures

Overall, the FDIC strongly supports the FRB's efforts to improve the effectiveness of the disclosures that consumers receive from creditors at application and throughout the life of the HELOC. The amendments to the disclosures represent a substantial improvement over the existing disclosures. Eliminating the current generic disclosures and replacing them with new transaction-specific disclosures based on both the current available rate, and the maximum rate which may apply, based on a fully utilized line of credit, more fully informs the consumer about the maximum monthly payment amounts that might apply, thus reducing payment shock. We also support the FRB's proposal to require that disclosures be provided in tabular format, in a manner that makes important terms both more conspicuous and more readable.

Appendix A

Technical Enhancements to Proposed Disclosures

FDIC staff have reviewed the proposed disclosures and suggest the following changes discussed in more detail below: 1) Adding an early disclosure for fixed rate loans; 2) Adding disclosures on the risks of simple interest loans; and 3) Clarifying elements of the model product disclosures.

Early Disclosures

We support the FRB's proposed changes to the ARM loan program disclosure, and strongly recommend that the FRB add a similar early disclosure for fixed-rate loans. The proposed ARM disclosure would convey information about the risky features of the ARM product early enough in the application process to assist the consumer in the shopping process. The FRB's consumer testing revealed that "[m]ost participants stated that once they had applied for a particular loan and received a TILA disclosure they ceased shopping."[7] Although the interest rate and payment portion of the ARM disclosure would be inapplicable to fixed-rate loans, most of the key questions about risk would apply. If consumers cease shopping once they have made an application, as the consumer testing reveals, the key questions about risk should be answered early enough in the process to enable consumers to make informed decisions.

"Simple Interest" Loans

First, FDIC staff recommends several changes to address the unique nature of "simple interest" loans. The key questions about risk should be expanded to include disclosure of a "simple interest" feature among the risky loan features. "Simple interest" mortgages, particularly when promoted to financially unsophisticated borrowers, may result in the borrower owing significant additional interest on the loan, unless he or she systematically makes the required monthly payment on or before its due date. Because "simple interest" mortgages entail the calculation of interest on a daily basis (rather than on a monthly basis), where the payment is applied as of the date received, and not on the payment due date, significant additional interest charges may apply where the borrower frequently pays late, even where payments are late by just a few days. Borrowers should be aware of this risk when selecting a loan. Moreover, post-closing, creditors should be required to provide periodic statements in connection with mortgage loans that have a "simple interest" feature, so that borrowers are informed of all the consequences of late payment. Without periodic statements, accrued interest may be obscured until the borrower attempts to pay off the loan, or until the loan's scheduled maturity date, when it is too late for the borrower to change payment behavior to mitigate what may be a significant balloon payment.

"Clarifications" proposed in connection with comment 3 to section 226.17(c)(2)(i) would serve to further obscure the risk of additional interest associated with "simple interest" loans, absent the changes that we have suggested above. The proposed clarification would reflect that creditors should not label the APR as "estimated" on "simple interest" loans, but rather should

[7] 74 Fed. Reg. 43235.

disclose based on the assumption that the consumer will adhere to the terms of the legal obligation. We recommend deleting the proposed clarification to comment 3 in section 226.17(c)(2)(i) because it would further obscure the risk of additional interest associated with "simple interest" loans.

Proposed Model Form Comments and Recommendations

FDIC staff commends the FRB for proposing that "key questions about risk" be prominently featured in the various TILA disclosures. Risky terms such as adjustable-rate features, negative amortization, interest-only, prepayment penalties, and balloon payments, among others, need to be clearly and prominently disclosed, early in the application process, in order to enable consumers to effectively shop for and select an appropriate mortgage loan. Moreover, we support enabling consumers to compare their rates to the average prime offer rate and the higher-priced mortgage loan rate.

We also offer a few specific suggestions to improve the proposed model TILA disclosure, as illustrated in the attached marked-up model disclosure form (for ease of reference, our comments are to proposed form H-19(A) Fixed Rate Mortgage Model Form)(attached as Exhibit 1):

(1) We are concerned that the language below the graphical illustration of the APR may be confusing to consumers. The last two sentences in the APR section state: "**How much could I save by lowering my APR?** For this loan, a ___% reduction in the APR could save you an average of $____ each month." The purpose of these statements may be more clearly conveyed through the use of alternative phrasing such as, "**How would a lower APR affect my payment?** For this loan, a ___% reduction could reduce my payment by, on average $______ each month."

(2) The "Interest Rate and Payment Summary" portion of the proposed model form would require that the Estimated Taxes & Insurance be disclosed only if the creditor will establish an escrow account. The second page of the TILA disclosure would direct consumers to the Good Faith Estimate (GFE) or HUD-1 form for more details when an escrow account is not required. Borrowers need to have a clear understanding of their total housing-related obligations, in order to determine whether they can afford them. It may be confusing for consumers to see two different monthly payment amounts as between the GFE (which includes the estimated taxes and insurance regardless of whether the creditor will escrow) and the TILA disclosures. We therefore recommend disclosure of the estimated taxes and insurance on the first page of the TILA disclosure regardless of whether the creditor will establish an escrow account. The disclosure should, in such a case, identify whether the taxes and insurance will be paid to the creditor (in connection with an escrow account) or directly to the taxing authority/insurer.

(3) We recommend that several of the statements found at the bottom of the second page of the proposed model form be made more prominent. The statement that reads: "**You have no obligation to accept this loan.** [Your signature below only

confirms that you have received this form.]" should be placed directly above the signature line (if the creditor includes a signature line).

(4) We also believe that greater prominence should be afforded to the disclosure that reads: "**If you are unable to make the payments on this loan, you could lose your home.** There is no guarantee that you will be able to refinance to lower your rate and payments." It is vital that consumers understand that there is a risk of loss of the home. Currently, this disclosure is mixed in with statements that the borrower may be less likely to read. Accordingly, we suggest that this disclosure be in its own box with a bolded, "**WARNING**" label to attract consumers' attention.

Exhibit 1

FDIC Proposed Revisions

H-19(A) Fixed Rate Mortgage Model Form

(Name of Creditor)
(Loan Originator Unique Identifier)

LOAN SUMMARY

Loan Amount:	**$_____**
Loan Term:	***(length of term)***
Loan Type and Features:	**Fixed Rate Mortgage** • [Includes [interest-only payments][step-payments]]
Total Settlement Charges:	**$_____** • [$_____ of these charges are already included in your loan amount above.] • [This total does not include a down payment. See your Good Faith Estimate or HUD-1 for details.]
[Prepayment Penalty:	Up to **$_____** if you pay off your loan, refinance, or sell this property within (*period*).]

ANNUAL PERCENTAGE RATE (APR)

Overall cost of this loan, including interest and settlement charges: _____% APR

Avg. Best APR

high cost zone

How does this loan compare? For the week of (*date*), the average APR on similar [but]conforming loans offered to applicants with excellent credit was ___%. Today, an APR of ___% or above is considered high cost and is usually available to applicants with poor credit history.

(1) **How ~~much could I save by lowering my APR~~ would a lower APR affect my payment?** For this loan, a __% reduction ~~in the APR could save you an~~ could reduce my payment by, on average ~~of~~ **$_____ each month.**

INTEREST RATE AND PAYMENT SUMMARY

	Rate & Monthly Payment
Interest Rate	____%
Principal + Interest Payment	$_____
(2) Est. Taxes + Insurance (Escrow) • [Includes [Private] Mortgage Insurance]	$_____
Total Est. Monthly Payment	**$_____**

Taxes and insurance should be disclosed even if the creditor does not require an escrow account.

KEY QUESTIONS ABOUT RISK

Can my interest rate increase?	No.
Can my monthly payment increase?	[No.][**YES.** Your payment can increase beginning in (*date*).]
Could I owe a prepayment penalty?	[No.][**YES.** If you pay off your loan, refinance, or sell your home within (***period***) you could pay a penalty of up to **$_____**.]

MORE INFORMATION ABOUT YOUR PAYMENTS

[Payment Change Limits]	[Your minimum payments due cannot increase more than ___% each (*period*) until (*description of recast event*). [When this happens][Beginning in (*period*)], you must make full monthly payments that cover all principal and interest owed on the loan.]
Escrow	[An escrow account is required for property taxes and insurance (such as homeowner's insurance). Your escrow payment is an estimate and can change at any time. See your Good Faith Estimate or HUD-1 form for more details.][An escrow account is not required on this loan. You must pay your property taxes, homeowners, and other insurance on your own.]
[[Private] Mortgage Insurance]	[[Private] Mortgage Insurance [(PMI)] **is** required for this loan. It is included in your escrow.]
Total Payments	If you made all payments as scheduled, you would make (*number*) payments totaling $_____[, including estimated escrow]. Of this amount, $_____ would go to interest and settlement charges. This amount, and your amount financed of $_____, are used to calculate your APR.

WARNING:

Move this statement directly above signature line, where the form provides one.

(3) ➔ **You have no obligation to accept this loan.** [Your signature below only confirms that you have received this form.]

[In a box for prominence]

(4) ➔ **If you are unable to make the payments on this loan, you could lose your home.** There is no guarantee that you will be able to refinance to lower your rate and payments.

➔ [If you borrow more than your home is worth, the interest on the extra amount may not be deductible for federal income tax purposes. Consult a tax advisor to find out whether the interest you pay is deductible.]

➔ **If you do not understand any part of this form, ask questions.** For more information, go to (*Web site of the Federal Reserve Board*).